

U.S. TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE

# FOREST INDUSTRIES SCHEDULE

Supplemental to the Income Tax Return Form for Taxpayers  
Operating, Buying, Leasing, or Selling Timber Lands



For the taxable year ended \_\_\_\_\_  
(State year(s) to which this schedule applies)

Taxpayer \_\_\_\_\_  
(Name)

Address (business) \_\_\_\_\_

Business \_\_\_\_\_

Check type: Corporation ☐; Partnership ☐; Fiduciary ☐; Individual ☐

This schedule should be submitted in duplicate (except that only one set of maps is required) attached to, and filed with the income tax return



## INSTRUCTIONS TO TAXPAYER

This schedule should be filled in and filed with the income tax return by each taxpayer who has cut standing timber owned, leased, or under contract by him, or who has acquired standing timber by purchase, lease, or otherwise, or who has relinquished standing timber by sale, lease, or otherwise, or who has sold cutover forest land during the taxable year or who has elected in his income tax returns to claim gain or loss from the cutting of timber in accordance with section 631(a) of the Internal Revenue Code of 1954. Only those parts of this schedule which are applicable to the property of the taxpayer should be filled in.

This schedule, Form T (Timber), should be filled in as accurately as the records of the taxpayer permit. Frequently it will be found that it does not give sufficient space for the taxpayer to enter the required information. However, it should be used as an outline in assembling the information required. In making answer on separate sheets it is unnecessary to repeat the question, but each answer should be numbered so as to identify it with the question asked.

### A. MAPS

1. If the taxpayer elects in its income tax return to claim gain or loss from the cutting of timber under section 631(a) as covered under items 58 to 65, inclusive, of this schedule, the furnishing of a map (or maps) is optional with the taxpayer, except that the Commissioner will require maps in individual cases if the information submitted is not clear. Maps furnished should show the name of the taxpayer and the year covered. Maps of convenient size are desirable, varying in scale from 4 inches to the mile in small tracts to  $\frac{1}{2}$  inch to the mile in large tracts. The following standard colors and symbols will be found convenient.

#### COLORED YELLOW

2. Merchantable timber acquired during the taxable year (whether or not the land under the timber was also acquired). This classification should include areas from which part, but not all, of the merchantable timber had been removed before it was acquired by the taxpayer.

#### UNCOLORED WITH BLACK HORIZONTAL HATCHING

3. Cutover land and other land not bearing merchantable timber acquired during the taxable year.

#### BLACK VERTICAL HATCHING

4. Merchantable timber cut during the taxable year. (If the merchantable timber has been cut clean, the hatching lines should be unbroken; if only part of the merchantable timber has been cut, the hatching lines should be broken.)

#### RED DIAGONAL HATCHING

5. Merchantable timber or untimbered land sold, or otherwise disposed of, during the taxable year. (In case land, having timber standing upon it, has been sold and the timber has been reserved from sale, such land should not be included in this classification.)

### B. PURCHASES

6. For the taxable year, report purchases (or other acquisition, as by trade) of timber or land or both. Each single purchase involving a total consideration of \$2,000 or more should be reported separately, stating month and year of purchase. Purchases for considerations less than \$2,000 may be reported in the aggregate for each timber or land account, omitting to answer item 9 for such aggregates of small purchases. In case of a purchase or lease of timber on a stumpage basis, to be paid for at intervals during the cutting period in accordance with the number of units cut, do not answer items 10 to 14, inclusive, but give instead a brief digest of the principal provisions of the purchase or lease agreement, including the number of years from effective date to date of expiration, minimum cut or payment, and the rate or rates of payment for the different kinds of timber and forest products involved. Small purchases on a stumpage basis completed within the taxable year may be reported in the aggregate. Insert as many additional sheets covering the following outline, items 7 to 16, as may be necessary:

7. Name of block and title of account.....

8. Location of property (by legal subdivisions, map, or best description possible) .....

9. Name and address of vendor with exact date of purchase .....

10. Amount paid: (a) in cash ..... \$ .....

(b) in interest bearing notes ..... \$ .....

(c) in non-interest bearing notes ..... \$ .....

11. (a) Amount paid in other considerations, \$ .....

(b) Explanation as to nature of other considerations and how value given in 11(a) was determined .....

12. (a) Legal expense, \$ .....

(b) Cruising, surveying, and other acquisition costs, \$ .....

13. Total price paid for property (sum of 10 to 12(b)), \$ .....

14. Allocation of total price as on books:

	<i>Per unit</i>	<i>Total cost</i>
(a) Land, ..... acres at \$ .....	\$ .....	\$ .....
(b) Saw timber, ..... M feet at \$ .....	\$ .....	\$ .....
(c) Other timber ....., \$ .....	\$ .....	\$ .....
(d) Young growth ....., \$ .....	\$ .....	\$ .....

Other items included in purchase:

(e) .....	\$ .....
(f) .....	\$ .....

NOTE.—Total of values under 14 (a), (b), (c), (d), (e), and (f) should equal 13.

15. Area acquired in acres of—

(a) Timberland .....	.....
(b) Cut-over land .....	.....
(c) Other surface land .....	.....
(d) Timber rights apart from land .....	.....

NOTE.—Total of 15 (a), (b), and (c) should equal area reported in 14(a).

16. Estimated total quantity of timber present upon the date of purchase. (Give this estimate in detail, as made for purposes of the purchase, showing if possible the quantity of each species of saw timber and of other forest products, such as pulpwood, poles, ties, and bark, each measured in the customary units; stating the name of the log rule or other unit of measure used. State whether timber was virgin, or second growth, or whether it had been culled for certain species, or worked for some product such as turpentine.)

(a) On the area cut over in each purchase give the actual log scale cut as compared with the original estimate.

## C. PROFIT OR LOSS FROM SALES OF LAND AND/OR TIMBER

17. For the taxable year, report all sales (or other disposition, as by trade) of timber or timberland. Each single sale involving a total consideration of \$2,000 or more should be reported separately. Sales for considerations of less than \$2,000 may be reported in the aggregate for each timber or land account, omitting to answer item 20 for such aggregates of small sales. In case of a sale or lease of timber on a stumpage basis, to be paid for at intervals during the cutting period in accordance with the number of units cut, answer items 21, 25, and 26 for the taxable year only; and instead of answering items 22, 23, and 24, give a brief digest of the principal provisions of the sale or lease agreement, including the number of years from effective date to date of expiration, minimum cut or payment, and the rate or rates of payment for the different kinds of timber and forest products involved. Small sales on a stumpage basis completed within the taxable year may be reported in the aggregate. Insert as many additional sheets covering the following outline, items 18 to 27, as may be necessary:

18. Name of block and title of account .....

19. Location of property (by legal subdivisions, map, or best description possible):  
.....  
.....

20. Name and address of purchaser with exact date of sale .....

21. Amount received: (a) in cash ..... \$.....

(b) in interest bearing notes ..... \$.....

(c) in non-interest bearing notes ..... \$.....

22. Amount received in other considerations ..... \$.....

23. Explanation as to nature of other considerations and how value given in 22 was determined.....  
.....

24. Total amount received for property ..... \$.....

25. Total cost of property (or value as of March 1, 1913, of any items owned on that date):

*Totals*

(a) Land, ..... acres at ..... per acre ..... \$.....

(b) Saw timber, ..... M feet at ..... per M ..... \$.....

(c) Other timber ..... at ..... per M ..... \$.....

Other items included in sale:

(d) ..... \$.....

(e) Total cost or value ..... \$.....

(f) Expenses of sale (cruising, marking, selling, etc.) ..... \$.....

26. Profit or loss (item 24, or item 21 in case of lease, less items 25(e) and 25(f)) ..... \$.....

27. Estimated total quantity of timber upon the date of sale. (Give this estimate in detail, as made for purposes of the sale, showing if possible the quantity of each species of saw timber and of other forest products, such as pulpwood, poles, ties, and bark, each meas-

ured in the customary units, stating the name of the log rule or other unit of measure used. State whether timber was virgin, or second growth, or whether it had been culled for certain species, or worked for some product such as turpentine.)

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#### D. PROFIT OR LOSS FROM SALES OF CUTOVER LAND

28. For the taxable year, report sales (or other disposition, as by trade) of cutover lands. If more than one land account is carried, make a separate report for each account, using the following outline, items 29 to 35:

29. Area of land sold, exclusive of installment sales -----

30. Total consideration received (if not in cash and notes, attach explanation) -----

31. Total cost, or value as of March 1, 1913 -----

32. Explain how answer to 31 was determined -----

33. Profit or loss (item 30 less item 31) -----

34. Installment sales made in this taxable year:

(a)	(b)	(c)	(d)	(e)	(f)	(g)
Area	Total consideration	Cost or value Mar. 1, 1913	Total profit	Percent profit (d) ÷ (b)	Payment this year	Profit this year (f) × (e)

35. Installment sales made in prior years:

(a)	(b)	(c)	(d)	(e)	(f)
Year sold	Total profits	Profit reported in prior years	Percent profit	Payment this year	Profit this year (e) × (d)

#### E. LOSSES

36. If during the taxable year the taxpayer sustained any losses due to fire, insects, wind, or other causes, and if a deduction on account of such loss is claimed in the income tax return, give for each timber account separately a statement in proof of the loss, including the data called for in items 37 to 40, inclusive:

37. Cause of loss -----

38. Location and area of ground on which loss took place .....

39. Total loss (as deducted in return), \$ .....

39(a). Amount received from insurance, \$ .....

40. Explanation in detail of how total loss (39) was determined .....

#### F. CAPITAL RETURNABLE THROUGH DEPLETION

The data indicated, 41 to 56, inclusive, should be given separately for each timber account covering the changes, if any, which have taken place during the taxable year. Insert as many additional pages of the same form as may be necessary. Taxpayers depleting on the block basis must combine new purchases with the opening balances and use the average depletion rate shown on line 48 for all timber cut or sold, regardless of how long held.

	(1) Quantity in M feet board measure, log scale, or other unit <sup>1</sup>	(2) Cost or other basis (dollars)
41. Title of account (name of block or tract) .....		
42. Estimated quantity of timber and amount of capital returnable through depletion at end of the immediately preceding taxable year .....		
43. Increase or decrease of quantity of timber required by way of correction <sup>2</sup> .....		X X X
44. (a) Addition for growth (period covered ..... years) .....		X X X
(b) Transfers from young growth account .....		
(c) Transfers from deferred reforestation account .....		
45. Acquired during year .....		
46. Addition to capital during year <sup>3</sup> .....	X X X	
47. Total at end of year, before depletion (sum of lines 42 to 46, inclusive, in each column) .....		
48. Unit rate returnable through depletion; or basis of sales or losses (47(2) divided by 47(1)) .....	X X X	
49. Quantity of timber cut during year <sup>4</sup> .....		X X X
50. Depletion sustained (48 multiplied by 49) <sup>4</sup> .....	X X X	
51. Quantity of timber sold or otherwise disposed of during year .....		X X X
52. Allowable as basis of sale (48 multiplied by 51) .....	X X X	
53. Quantity of timber lost by fire or other cause during year .....		X X X
54. Allowable as basis of loss (48 multiplied by 53) .....	X X X	
55. Total reductions during year:		
(a) Sum of 49(1) plus 51(1) plus 53(1) .....		X X X
(b) Sum of 50(2) plus 52(2) plus 54(2) .....	X X X	
56. Net quantity and value at end of year (47(1) minus 55(a)(1) and 47(2) minus 55(b)(2)) .....		

<sup>1</sup> Give name of log rule. If M feet, log scale, is not the unit used, state what unit was used and explain the unit of measure.

<sup>2</sup> The quantity in M feet, log scale, or other unit remaining at the end of the year should be adjusted for changes in standards of utilization, scattered and/or indefinitely ascertained losses, inaccuracy of the former estimate, or change in the log scale if the log rule now in use differs from the one used as the basis for depletion in prior years. If such a change is made, the basis upon which it is made should be clearly stated.

<sup>3</sup> Such an addition should be analyzed to show the items included. Here are included expenditures for taxes, administration, protection, interest actually paid, etc., if such expenditures have not been treated as expense deductions in the return. Expenditures for reforestation, such as site preparation, planting, seeding, etc., should ordinarily be carried in a separate deferred account.

<sup>4</sup> If an election is made to claim gain or loss from the cutting of timber under section 631(a), as covered under items 58 to 65, inclusive, all timber acquired during the current taxable year as well as timber acquired within 6 months prior to the beginning of the taxable year should be reported separately both as to the quantity cut and the amount of depletion, with the average unit rate applicable to both.

57. If all the timber reported cut (item 49 above) was not manufactured by taxpayer, state quantity of cut timber that was sold as logs, or other cut products, giving names of principal purchasers.....  
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 -----

58. Did the taxpayer elect in its income tax return to claim gain or loss from the cutting of its timber in accordance with section 631(a) of the Internal Revenue Code of 1954? -----  
 If such election was made, the following information should be furnished: (Yes or No)

59. Gain or loss as reported in the return showing the adjusted basis for depletion and the fair market value claimed by species and unit rates (if claimed on a species basis).

60. The date of acquisition of timber which was cut in taxable year, if acquired subsequent to March 1, 1913, the quantity of timber remaining (adjusted for growth, correction of estimates, changes in utilization, and change in the log rule used, if any), and the adjusted basis at the beginning of the taxable year. State the acreage cutover and the amount of timber cut therefrom during the taxable year, and the log rule or other method used in determining the quantity of timber cut. Where depletion accounts have been kept by separate tracts or purchases, the information should be stated separately for each tract or timber purchase.

In all cases where an average depletion rate based on the average value and/or cost of the timber block has been used in prior years, the adjusted basis referred to in section 631(a) is the average basis shown in item 48, after adjustment.

61. Section 631(a) requires the determination of the fair market value as of the beginning of the taxable year of the timber cut during that year which has been owned by the taxpayer, or upon which he has held a contract right to cut, for a period of more than 6 months prior to the beginning of the taxable year. Accordingly, it is necessary to state in detail the factors with respect to the timber cut which affect its value, such as character, quality and stand per acre, logging conditions and topography, and accessibility to mill or market, etc. (See also section 611 of the Code.) It should be stated whether the timber cut was virgin or second growth or whether it had been culled for certain species, or worked for some product such as turpentine. Also give the quantity, kind and character of timber left per acre for later cutting, if any.

62. Evidence in the form of bona fide arm's-length transactions in comparable timber as of the basic date should be furnished. Such evidence must be sufficiently detailed to permit of comparison with the timber on which a value is claimed.

If depletion by species or groups, or selective depletion, or depletion for pulpwood, poles, posts or other timber products, is claimed, and if transactions of other parties are furnished, the actual quantity log scale and/or other units of timber cut should be submitted.

63. For all purchases and sales of timber by the taxpayer, and for all other transactions reported, the relevant information called for by items 6 to 27, inclusive, should be furnished.

64. The following additional information should be furnished:

- (a) Description of the log transportation system used, such as truck roads, railroads, drivable streams, etc., and the main topographic features of the area cutover during the year, as they affect logging and transportation conditions. This may be shown in accompanying maps.
- (b) The location of the sawmill, log market, or other point of delivery to the user or buyer should be stated.
- (c) The total log scale and/or other units of timber cut, with a statement as to the number of logs per M, giving the length and diameter of the average log if an average value is claimed, and the same information for each species or group if species or group values are claimed.

- (d) Information similar to that called for under (a), (b) and (c) above, together with supporting maps, should be furnished with respect to the transactions which are relied on to substantiate the values claimed.
- (e) The percentage of rough lumber grades, by species, produced from the timber manufactured during the year or, if the timber is sold in the log, the percentage of log grades, by species, should be stated.

65. Section 631(a) is restricted to timber owned, or upon which a contract right to cut is held, for more than 6 months prior to the beginning of the taxable year; accordingly scale records of timber cut must be kept so as to show separately the timber cut (a) which has not been owned for such period and (b) which has been owned for such period. The scale by species of the logs purchased during the year must also be stated and eliminated from the footage on which a value is claimed. In this connection describe the logs by size and quality and give the cost and point of delivery.

#### G. PHYSICAL PROPERTY

66. Show changes in the physical property accounts during the taxable year, giving first the total or summary, followed by division into different classes, as carried on the books of the taxpayer. The following table may be extended as far as necessary:

	Total	By classes of property			
67. Gross cost at beginning of year					
(a) Depreciation reserve					
(b) Net cost					
68. Additions during year					
69. Reductions during year					
70. Total before depreciation (67 plus 68 minus 69)					
71. Depreciation sustained					
72. Balance at end of year					

73. Is answer to item 68 the cost of additions in cash and notes? \_\_\_\_\_ If  
 answer is "No," explain basis for additions reported \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

74. Method of calculating depreciation \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_



## 75. Profit or loss from sale of physical property:

- (a) Items sold .....
- (b) Selling price .....
- (c) Depreciated (net) cost .....
- (d) Profit or loss .....

## H. OPERATION

Raw Material Handled		Finished Products Handled	
<p>For each manufacturing operation, state the quantities of raw material handled during the year. State the unit of measure, as 1,000 feet, log scale, cords, linear feet, etc. State what scale was used, and give the name of the log rule used. Use a table similar to the following for each different sort of product.</p>		<p>For each manufacturing operation, state the quantity of lumber handled in 1,000 feet, board measure, lumber tally, during the year; using a table similar to the following. Prepare also a separate similar table for each product not measured in feet-board measure, lumber tally. Do not enter costs or values.</p>	
Product .....	Quantity	Unit of measure .....	Quantity
Unit of measure .....			
Describe unit of measure .....			
<b>Debits</b>		<b>Debits</b>	
76. Inventory at beginning of year .....		87. Lumber inventory at beginning of year .....	
77. Material cut in woods .....		88. Inventory adjustments (increase) .....	
78. Material purchased .....		89. Purchases of lumber .....	
79. Inventory adjustments (see note 1) .....			
80. TOTAL DEBITS .....		90. TOTAL DEBITS .....	
<b>Credits</b>		<b>Credits</b>	
81. Sold to other operators .....		91. Lumber inventory at end of year .....	
82. Losses (see note 2) .....		92. Inventory adjustments (decrease) .....	
83. Inventory adjustments (see note 1) .....		93. Sales of lumber plus lumber used .....	
84. Inventory at end of year .....		94. Losses of lumber .....	
85. TOTAL CREDITS .....		95. TOTAL CREDITS .....	
86. Quantity used during year .....		96. Lumber cut during year .....	
(80 minus 85)		(95 minus 90)	
		97. Logs sawed during year .....	
		(same as 86)	
		(State in terms of log scale)	
		98. Over run or under run: Quantity of lumber cut (lumber tally) over or under logs sawed, log scale .....	
		99. Over run or under run, percent .....	

NOTE 1.—Enter the correction for ascertained errors in the inventory for the previous year; if the quantity was understated, enter under "debits"; if overstated, enter under "credits."

NOTE 2.—Include only those losses in quantity due to sinkage, breakage, boomage, etc., sustained in handling from stump to manufacturing plant, or to point of sale, as the case may be.

**I. LAND OWNERSHIP**

100. Show changes in land accounts as carried on the books. Insert as many additional sheets covering the following outline, items 101 to 112, as may be necessary.

101. Name of account.....	Acres	Total cost and/or value (see note 1)	Average rate per acre
102. Balance at beginning of year.....	-----	-----	-----
103. Purchases during year.....	-----	-----	-----
104. Sales during year.....	-----	-----	-----
105. Other changes.....	-----	-----	-----
106. Balance at end of year.....	-----	-----	-----

NOTE 1.—State amount of March 1, 1913 appreciation, if included.

107. Show changes during the year in area of land owned, by classes, for the above account.

	Acres of—		
	(a) Timberland	(b) Cutover land	(c) Other land
108. Balance at beginning of year.....	-----	-----	-----
109. Purchases during year.....	-----	-----	-----
110. Sales during year.....	-----	-----	-----
111. Cut over during year.....	-----	-----	X X X X
112. Balance at end of year.....	-----	-----	-----

NOTES: Insert area of timberland cutover during year in both 110(a) and 110(b).

112(a) equals 108(a) plus 109(a) minus 110(a) minus 111(a).

112(b) equals 108(b) plus 109(b) minus 110(b) plus 111(b).

112(c) equals 108(c) plus 109(c) minus 110(c).

**EXCERPTS FROM CODE AND REGULATIONS RELATING TO DETERMINATION OF TAXABLE INCOME IN THE CASE OF OPERATING TIMBER OWNERS, AND IN THE CASE OF DISPOSAL OF STANDING TIMBER BY THE OWNER UNDER A LEASE AGREEMENT**

**Natural Resources**

**SALES AND EXCHANGES**

**§ 1.631 STATUTORY PROVISIONS; GAIN OR LOSS IN THE CASE OF TIMBER OR COAL.**

**SEC. 631. GAIN OR LOSS IN THE CASE OF TIMBER OR COAL.**

(a) **ELECTION TO CONSIDER CUTTING AS SALE OR EXCHANGE.**—If the taxpayer so elects on his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than 6 months before the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. If such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the fair market value of such timber, and the adjusted basis for depletion of such timber in the hands of the taxpayer. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this subsection, such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding on the taxpayer for the taxable year for which the election is made and for all subsequent years, unless the Secretary or his delegate, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this subsection except with the consent of the Secretary or his delegate. For purposes of this subsection and subsection (b), the term "timber" includes evergreen trees which are more than 6 years old at the time severed from the roots and are sold for ornamental purposes.

(b) **DISPOSAL OF TIMBER WITH A RETAINED ECONOMIC INTEREST.**—In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if the payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term "owner" means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.

\* \* \* \* \*

§ 1.631-1 **ELECTION TO CONSIDER CUTTING AS SALE OR EXCHANGE.**—(a) *Effect of election.*—(1) Section 631(a) provides an election to certain taxpayers to treat the difference between the actual cost or other basis of certain timber cut during the taxable year and its fair market value as standing timber on the first day of such year as gain or loss from a sale or exchange under section 1231. Thereafter, any subsequent gain or loss shall be determined in accordance with paragraph (e) of this section.

(2) For the purposes of section 631(a) and this section, timber shall be considered cut at the time when in the ordinary course of business the quantity of timber felled is first definitely determined.

(3) The election may be made with respect to any taxable year even though such election was not made with respect to a previous taxable year. If an election has been made under the provisions of section 631(a), or corresponding provisions of prior internal revenue laws, such election shall be binding upon the taxpayer not only for the taxable year for which the election is made but also for all subsequent taxable years, unless the Commissioner on showing by the taxpayer of undue hardship permits the taxpayer to revoke his election for such subsequent taxable years. If the taxpayer has revoked a previous election, such revocation shall preclude any further elections unless the taxpayer obtains the consent of the Commissioner.

(4) Such election shall apply with respect to all timber which the taxpayer has owned, or has had a contract right to cut, for a period of more than six months prior to the beginning of the taxable year in which such timber is cut for sale or for use in the taxpayer's trade or business, irrespective of whether such timber or contract right was acquired before or after the election. (For purposes of the preceding sentence, the rules with respect to the holding period of property contained in sec. 1223 shall be applicable.) However, timber which is not cut for sale or for use in the taxpayer's trade or business (for example, firewood cut for the taxpayer's own household consumption) shall not be considered to have been sold or exchanged upon the cutting thereof.

(b) *Who may make election.*—(1) A taxpayer who has owned, or has held a contract right to cut, timber for a period of more than six months before the beginning of the taxable year may elect under section 631(a) to consider the cutting of such timber during such year for sale or for use in the taxpayer's trade or business as a sale or exchange of the timber so cut. In order to have a "contract right to cut timber" within the meaning of section 631(a) and this section, a taxpayer must have a right to sell the timber cut under the contract on his own account or to use such cut timber in his trade or business.

(2) For purposes of section 631(a) and this section, the term "timber" includes evergreen trees which are more than six years old at the time severed from their roots and are sold for ornamental purposes, such as Christmas decorations. Section 631(a) is not applicable to evergreen trees which are sold in a live state, whether or not for ornamental purposes. Tops and other parts of standing timber are not considered as evergreen trees within the meaning of section 631(a). The term "evergreen trees" is used in its commonly accepted sense and includes pine, spruce, fir, hemlock, cedar, and other coniferous trees.

(c) *Manner of making election.*—The election under section 631(a) must be made by the taxpayer in his income tax return for the taxable year for which the election is applicable, and such election cannot be made in an amended return for such year. The election in the return shall take the form of a computation under the provisions of section 631(a) and section 1231.

(d) *Computation of gain or loss under the election.*—(1) If the cutting of timber is considered as a sale or exchange pursuant to an election made under section 631(a), gain or loss shall be recognized to the taxpayer in an amount equal to the difference between the adjusted basis for depletion in the hands of the taxpayer of the timber which has been cut during the taxable year and the fair market value of such timber as of the first day of the taxable year in which such timber is cut. The adjusted basis for depletion of the cut timber shall be based upon the number of units of timber cut during the taxable year which are considered to be sold or exchanged and upon the depletion unit of the timber in the timber account or accounts pertaining

to the timber cut, and shall be computed in the same manner as is provided in section 611 and the regulations thereunder with respect to the computation of the allowance for depletion.

(2) The fair market value of the timber as of the first day of the taxable year in which such timber is cut shall be determined, subject to approval or revision by the district director upon examination of the taxpayer's return, by the taxpayer in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at the date, regardless of all subsequent changes, such as changes in surrounding circumstances, methods of exploitation, degree of utilization, etc. The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer as of that particular day. Due consideration will be given to the factors and the principles involved in the determination of the fair market value of timber as described in the regulations under section 611.

(3) The fair market value as of the beginning of the taxable year of the standing timber cut during the year shall be considered to be the cost of such timber, in lieu of the actual cost or other basis of such timber, for all purposes for which such cost is a necessary factor. See paragraph (e) of this section.

(4) For any taxable year for which the cutting of timber is considered to be a sale or exchange of such timber under section 631(a), the timber so cut shall be considered as property used in the trade or business for the purposes of section 1231, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether such timber is property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether the gain or loss considered to have resulted from the cutting of the timber will be considered to be gain or loss resulting from the sale or exchange of capital assets held for more than six months depends upon the application of section 1231 to the taxpayer for the taxable year. See section 1231 and the regulations thereunder.

(e) *Computation of subsequent gain or loss.*—(1) In case the products of the timber are sold after cutting, either in the form of logs or lumber or in the form of manufactured products, the income from such actual sales shall be considered ordinary income. When the election under section 631(a) is in effect, the cost of standing timber cut during the taxable year is determined as if the taxpayer had purchased such timber on the first day of the taxable year. Thus, in determining the cost of the products so sold, the cost of the timber shall be the fair market value on the first day of the taxable year in which the standing timber was cut, in lieu of the actual cost or other basis of such timber.

(2) This is also the rule in case the products of the timber cut during one taxable year, with respect to which an election has been made under section 631(a), are sold during a subsequent taxable year, whether or not the election provided in section 631(a) is applicable with respect to such subsequent year. If the products of the timber cut during a taxable year with respect to which an election under section 631(a) was made were not sold during such year and are included in inventory at the close of such year, the fair market value as of the beginning of the year of the timber cut during the year shall be used in lieu of the actual cost of such timber in computing the closing inventory for such year and the opening inventory for the succeeding year. With respect to the costs applicable in the determination of the amount of such inventories, there shall be included the fair market value of the timber cut, the costs of cutting, logging, and all other expenses incident to the cost of converting the standing timber into the products in inventory. See section 471 and the regulations thereunder. The fact that the fair market value as of the first day of the taxable year in which the timber is cut is deemed to be the cost of such timber shall not preclude the taxpayer from computing its inventories upon the basis of cost or market, whichever is lower, if such is the method used by the taxpayer. Nor shall it preclude the taxpayer from computing its inventories under the last-in-first-out inventory method provided by section 472 if such section is applicable to, and has been elected by, the taxpayer.

#### § 1.631-2 GAIN OR LOSS UPON THE DISPOSAL OF TIMBER UNDER CUTTING CONTRACT.—

(a) *In general.*—(1) If an owner disposes of timber held for more than six months before such disposal, under any form or type of contract whereby he retains an economic interest in such timber, the disposal shall be considered to be a sale of such timber. The difference between the amounts realized from disposal of such timber in any taxable year and the adjusted basis for depletion thereof shall be considered to be a gain or loss upon the sale of such timber for such year. Such adjusted basis shall be computed in the same manner as provided in section 611 and the regulations thereunder with respect to the allowance for depletion. See paragraph (e)(2) of this section for definition of "owner". For the purpose of determining whether or not the timber disposed of was held for more than six months before such disposal, the rules with respect to the holding period of property contained in section 1223 shall be applicable.

(2) In the case of such a disposal, the provisions of section 1231 apply and such timber shall be considered to be property used in the trade or business for the taxable year in which

it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether such timber is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the timber which is considered to have been sold will be deemed to be gain or loss resulting from a sale of a capital asset held for more than six months will depend upon the application of section 1231 to the taxpayer for the taxable year.

(b) *Determination of date of disposal.*—(1) For purposes of section 631(b) and this section, the date of disposal of timber shall be deemed to be the date such timber is cut. However, if payment is made to the owner under the contract for timber before such timber is cut the owner may elect to treat the date of payment as the date of disposal of such timber. Such election shall be effective only for purposes of determining the holding period of such timber. Neither section 631(b) nor the election thereunder has any effect on the time of reporting gain or loss. See subchapter E of chapter 1 of the Internal Revenue Code of 1954 and the regulations thereunder. See paragraph (c)(2) of this section for the effect of exercising the election with respect to the payment for timber held for six months or less. See paragraph (d) of this section for the treatment of payments received in advance of cutting.

(2) For purposes of section 631(b) and this section, the "date such timber is cut" means the date when in the ordinary course of business the quantity of timber felled is first definitely determined.

(c) *Manner and effect of election to treat date of payment as the date of disposal.*—(1) The election to treat the date of payment as the date of disposal of timber shall be evidenced by a statement attached to the taxpayer's income tax return filed on or before the due date (including extensions thereof) for the taxable year in which the payment is received. The statement shall specify the advance payments which are subject to the election and shall identify the contract under which the payments are made. However, in no case shall the time for making the election under section 631(b) expire before the close of the 90th day after the regulations adopted under section 631 are published in the Federal Register.

(2) Where the election to treat the date of payment as the date of disposal is made with respect to a payment made in advance of cutting, and such payment is made six months or less from the date the timber disposed of was acquired, section 631(b) shall not apply to such payment, irrespective of the date such timber is cut, since the timber was not held for more than six months prior to disposal.

(d) *Payments received in advance of cutting.*—(1) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to cutting (such as advance royalty payments or minimum royalty payments) shall be treated under section 631(b) as realized from the sale of timber if the contract of disposal provides that such amounts are to be applied as payment for timber subsequently cut. Such amounts will be so treated irrespective of whether or not an election has been made under paragraph (c) of this section to treat the date of payment as the date of disposal. For example, if no election has been made under paragraph (c), amounts received or accrued prior to cutting will be treated as realized from the sale of timber, provided the timber paid for is cut more than 6 months after the date of acquisition of such timber.

(2) However, if the right to cut timber under the contract expires, terminates, or is abandoned before the timber which has been paid for is cut, the taxpayer shall treat payments attributable to the uncut timber as ordinary income and not as received from the sale of timber under section 631(b). Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such payments were received or accrued. The recomputation shall be made in the form of an amended return where necessary.

(3) (i) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(b) as amounts realized from the sale of timber to the extent attributable to timber held for more than 6 months.

(ii) The adjusted depletion basis attributable to the bonus shall be determined under the provisions of section 612 and the regulations thereunder. This subdivision may be illustrated as follows:

*Example.* Taxpayer A has held timber having a depletion basis of \$90,000 for two months when he enters into a contract of disposal with B. B pays A a bonus of \$5,000 upon the execution of the contract and agrees to pay X dollars per unit of timber to A as the timber is cut. A does not exercise the election to treat the date of payment as the date of disposal. It is estimated that there are 50,000 units of timber subject to the con-

tract and that the total estimated royalties to be paid to A will be \$95,000. A must report the bonus in the taxable year it is received or accrued by him. The portion of the basis of the timber attributable to the bonus is determined by the following formula:

$$\frac{\text{Bonus}}{\text{Bonus} + \text{amount of expected royalties}} \times \text{Basis of timber} = \text{Basis attributable to bonus}$$

$$\frac{\$5,000}{\$100,000} \times \$90,000 = \$4,500$$

(iii) To the extent attributable to timber not held for more than 6 months, such bonuses shall be treated as ordinary income subject to depletion. In order to determine the amount of the bonus allocable to timber not held for more than six months, the bonus shall be apportioned ratably over the estimated number of units of timber covered by the contract of disposal. This subdivision may be illustrated as follows:

*Example.* Assume under the facts stated in the example in subdivision (ii) of this subparagraph that B cuts 10,000 units of timber that have been held by A for six months or less. The amount of the bonus (as well as the royalties) attributable to these units must be reported as ordinary income subject to depletion. The amount of the bonus attributable to these units is determined by the following formula:

$$\frac{\text{Number of units cut held for six months or less}}{\text{Total units covered by the contract}} \times \text{Amount of Bonus} = \text{Amount of bonus treated as ordinary income subject to depletion}$$

$$\frac{10,000}{50,000} \times \$5,000 = \$1,000$$

The amount of the depletion attributable to the portion of the bonus received for timber held for six months or less is determined by the following formula:

$$\frac{\text{Amount of bonus attributable to timber held for six months or less}}{\text{Total bonus}} \times \text{Adjusted basis for depletion of bonus} = \text{Depletion allowance on timber held for six months or less}$$

$$\frac{\$1,000}{\$5,000} \times \$4,500 = \$900$$

The amount of the bonus attributable to timber held for more than six months, and which is treated under section 631(b) as realized from the sale of timber would be \$4,000. The gain on such amount is \$400 (\$4,000—\$3,600).

(iv) If the right to cut timber under the contract of disposal expires, terminates, or is abandoned before any timber is cut, the taxpayer shall treat the bonus received under such contract as ordinary income, not subject to depletion. Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such bonus was received. The recomputation shall be made in the form of an amended return where necessary.

(e) *Other rules for application of section.*—(1) Amounts paid by the lessee for timber or the acquisition of timber cutting rights, whether designated as such or as a rental, royalty, or bonus, shall be treated as the cost of timber and constitute part of the lessee's depletable basis of the timber, irrespective of the treatment accorded such payments in the hands of the lessor.

(2) The provisions of section 631(b) apply only to an owner of timber. An owner of timber means any person who owns an interest in timber, including a sublessor and a holder of a contract to cut timber. Such owner of timber must have a right to cut timber for sale on his own account or for use in his trade or business in order to own an interest in timber within the meaning of section 631(b).

(3) For purposes of section 631(b) and this section, the term "timber" includes evergreen trees which are more than 6 years old at the time severed from their roots and are sold for ornamental purposes such as Christmas decorations. Tops and other parts of standing timber are not considered as evergreen trees within the meaning of section 631(b). The term "evergreen trees" is used in its commonly accepted sense and includes pine, spruce, fir, hemlock, cedar, and other coniferous trees.

## SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

## § 1.1231 STATUTORY PROVISIONS; PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

## SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) **GENERAL RULE.**—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion. In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.

(b) **DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.**—For purposes of this section—

(1) **GENERAL RULE.**—The term “property used in the trade or business” means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

(2) **TIMBER OR COAL.**—Such term includes timber and coal with respect to which section 631 applies.

(3) **LIVESTOCK.**—Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry.

(4) **UNHARVESTED CROP.**—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted) at the same time and to the same person, the crop shall be considered as “property used in the trade or business.”

§ 1.1231-1 **GAINS AND LOSSES FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.**—(a) *In general.*—Section 1231 provides that a taxpayer's gains and losses from the disposition (including involuntary conversion) of assets described in that section as “property used in the trade or business” and from the involuntary conversion of capital assets held for more than 6 months shall be treated as long-term capital gains and losses if the total gains exceed the total losses. If the total gains do not exceed the total losses, all such gains and losses are treated as ordinary gains and losses. Therefore, if the taxpayer has no gains subject to section 1231, a recognized loss from the condemnation (or from a sale or exchange under threat of condemnation) of even a capital asset held for more than 6 months is an ordinary loss. Capital assets subject to section 1231 treatment include only capital assets involuntarily converted. The non-capital assets subject to section 1231 treatment are (1) depreciable business property and business real property held for more than 6 months, other than stock in trade and certain copyrights and artistic property; (2) timber and coal, but only to the extent that section 631 applies thereto; and (3) certain livestock and unharvested crops. See paragraph (c) of this section.

(b) *Treatment of gains and losses.*—For the purpose of applying section 1231, a taxpayer must aggregate his recognized gains and losses from—

(1) The sale, exchange, or involuntary conversion of property used in the trade or business (as defined in section 1231(d)), and

(2) The involuntary conversion (but not sale or exchange) of capital assets held for more than 6 months.

If the gains to which section 1231 applies exceed the losses to which the section applies, the gains and losses are treated as long-term capital gains and losses and are subject to the provisions of sections 1201 through 1212, relating to capital gains and losses. If the gains to which section 1231 applies do not exceed the losses to which the section applies, the gains and losses are treated as ordinary gains and losses. Therefore, in the latter case, a loss from the involun-

tary conversion of a capital asset held for more than 6 months is treated as an ordinary loss and is not subject to the limitation on capital losses in section 1211. The phrase "involuntary conversion" is defined in paragraph (c) of this section.

(c) *Transactions to which section applies.*—Section 1231 applies to recognized gains and losses from the following:

(1) The sale, exchange, or involuntary conversion of property held for more than 6 months and used in the taxpayer's trade or business, which is either real property or is of a character subject to the allowance for depreciation under section 167 (even though fully depreciated), and which is not—

(i) Property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of business;

(ii) A copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in section 1221(3); or

(iii) Livestock held for draft, breeding, or dairy purposes, except to the extent included under subparagraph (4) of this paragraph, or poultry.

(2) The involuntary conversion of capital assets held for more than 6 months.

(3) The cutting or disposal of timber, or the disposal of coal, to the extent considered arising from a sale or exchange by reason of the provisions of section 631 and the regulations thereunder.

(4) The sale, exchange, or involuntary conversion of livestock if the requirements of § 1.1231-2 are met.

(5) The sale, exchange, or involuntary conversion of unharvested crops on land which is (i) used in the taxpayer's trade or business and held for more than 6 months, and (ii) sold or exchanged at the same time and to the same person. See paragraph (f) of this section.

For purposes of section 1231, the phrase "property used in the trade or business" means property described in this paragraph (other than property described in subparagraph (2) of this paragraph).

(d) *Extent to which gains and losses are taken into account.*—All gains and losses to which section 1231 applies must be taken into account in determining whether and to what extent the gains exceed the losses. For the purpose of this computation, the provisions of section 1211 limiting the deduction of capital losses do not apply, and no losses are excluded by that section. With that exception, gains are included in the computations under section 1231 only to the extent that they are taken into account in computing gross income, and losses are included only to the extent that they are taken into account in computing taxable income. The following are examples of gains and losses not included in the computations under section 1231:

(1) Losses of a personal nature which are not deductible by reason of section 165 (c) or (d), such as losses from the sale of property held for personal use;

(2) Losses which are not deductible under section 267 (relating to losses with respect to transactions between related taxpayers) or section 1091 (relating to losses from wash sales);

(3) Gain on the sale of property (to which section 1231 applies) reported for any taxable year on the installment method under section 453, except to the extent the gain is to be reported under section 453 for the taxable year; and

(4) Gains and losses which are not recognized under section 1002, such as those to which sections 1031 through 1036, relating to common nontaxable exchanges, apply.

(e) *Involuntary conversion.*—For purposes of section 1231, the terms "compulsory or involuntary conversion" and "involuntary conversion" of property mean the conversion of property into money or other property as a result of complete or partial destruction, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof. Losses upon the complete or partial destruction, theft, seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there is a conversion of the property into other property or money. For example, if a capital asset held for more than 6 months, with an adjusted basis of \$400, is stolen, and the loss is not compensated for by insurance or otherwise, section 1231 applies to the \$400 loss.

(f) *Unharvested crops.*—Section 1231 does not apply to a sale, exchange, or involuntary conversion of an unharvested crop if the taxpayer retains any right or option to reacquire the land the crop is on, directly or indirectly (other than a right customarily incident to a mortgage or other security transaction). The length of time for which the crop, as distinguished from the land, is held is immaterial. A leasehold or estate for years is not "land" for the purpose of section 1231.



(g) *Examples.*—The provisions of this section may be illustrated by the following examples:

*Example (1).* A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1957 of the kind described in section 1231 are as follows:

	Gains	Losses
1. Gain on sale of machinery, used in the business and subject to an allowance for depreciation, held for more than 6 months.....	\$4, 000	
2. Gain reported in 1957 (under sec. 453) on installment sale in 1956 of factory premises used in the business (including building and land, each held for more than 6 months).....	6, 000	
3. Gain reported in 1957 (under sec. 453) on installment sale in 1957 of land held for more than 6 months, used in the business as a storage lot for trucks.....	2, 000	
4. Gain on proceeds from requisition by Government of boat, held for more than 6 months, used in the business and subject to an allowance for depreciation...	500	
5. Loss upon the destruction by fire of warehouse, held for more than 6 months and used in the business (excess of adjusted basis of warehouse over compensation by insurance, etc.).....		\$3, 000
6. Loss upon theft of unregistered bearer bonds, held for more than 6 months.....		5, 000
7. Loss in storm of pleasure yacht, purchased in 1950 for \$1,800 and having a fair market value of \$1,000 at the time of the storm.....		1, 000
8. Total gains.....	12, 500	
9. Total losses.....		9, 000
10. Excess of gains over losses.....	3, 500	

Since the aggregate of the recognized gains (\$12,500) exceeds the aggregate of the recognized losses (\$9,000), such gains and losses are treated under section 1231 as gains and losses from the sale or exchange of capital assets held for more than six months.